costs than AT&T. (Hall, ¶ 204) That hypothesis might be true. Professors Hubbard and Lehr estimate that AT&T's average costs are about 14 cents per minute. (Hubbard and Lehr, ¶ 122) In contrast, as Professor Hall points out (Hall ¶ 139) and as I highlight above, some of the resellers charge rates as low as about 10 cents per minute, with no minimum charge and no monthly subscription fee. Therefore, I concede the possibility that AT&T's costs substantially exceed those of smaller carriers. If so, this gross inefficiency is a potent reason to allow BellSouth and other RBOCs into the long distance market promptly. The economic welfare gain from wringing out 40 percent excess costs from the carrier with over half the market would certainly exceed all other sources of economic gains or losses being discussed in this proceeding. Therefore, I appreciate the effort of Professors Hubbard and Lehr in estimating AT&T's costs. I hope that, in the future, they can build our confidence in their estimate by providing more details and support for their estimation procedure.

20. Thus, two alternative explanations could lead to the facts that the market share of the small carriers is growing and AT&T's is shrinking. Importantly, regardless of which alternative explanation for the market share trends is true, the policy prescription should be the same: allow RBOC entry into the long distance market. It is gratifying for once to find a situation in which competing hypotheses yield the same policy prescription rather than conflicting policies.

B. Professor Hall Regarding the Residential Long Distance Market

21. Professor Hall also makes errors regarding pricing for residential customers. He shows that long distance prices for business and residential customers together have decreased over time. (Hall, ¶¶ 126-129) No doubt they have. That is not the issue, since local exchange carriers have been reducing access charges. He does go on to discuss changes in average revenue per minute relative to changes in access charges, but again he reports results that combine business and residential customers. (Hall, ¶¶ 132-136) Such comparisons hide the increases in rates that residential customers have paid in recent years.

22. Professor Hall confirms my finding that the incumbent long distance carriers increased basic rates in the past few years, until the local exchange carriers reduced their access charges substantially in 1997. (Hall, ¶ 137)

23. Professor Hall asserts that "most residential customers take advantage of flat-rate low-price plans." (Hall, ¶ 142) His statement is unsupported. It is a general statement regarding residential customers in total, yet he only reports data for MCI. My declaration showed that the statement is false regarding AT&T residential customers. Since 62 percent of AT&T's customers in BellSouth states faced full basic rates in 1996 (Declaration, ¶ 10), and, since AT&T only recently introduced flat-rate plans, it is inconceivable that by now most AT&T residential customers "take advantage of flat-rate low-price plans." Further, the data he does report for MCI is regarding all MCI calling plans, not its flat-rate plans. Many of MCI's calling plans are not flat-rate plans. MCI's Friends & Family plans and its Sure-Save Reach plan instead specify discounts from basic rates. For these plans, if basic rates rise, then rates paid by subscribers to these plans also rise. In addition, MCI recently reduced the discounts it provides to Friends & Family plan subscribers.

24. Professor Hall reports that 78 percent of MCI's residential customers subscribe to calling plans (Hall, ¶ 142), but he does not reveal what fraction of customers actually *receive* discounts or what size of discount these customers receive. The data he reports for MCI is misleading. Note his careful phrasing: "About 22 percent of MCI's residential customers pay the standard rate—the remaining 78 percent use plans with lower rates, some of which depend on volume." (Hall, ¶ 142) For many of MCI's plans, unless a plan subscriber has a high volume of usage—either in total or to particular customers—then the subscriber can still pay prices that equal or exceed basic rates.[8] In any case, Professor Hall's statistic is of little comfort

[8] For instance, subscribers to MCI's Friends & Family Everywhere or Friends & Family Option C would have to make calls worth at least $9.50 per month to receive any discounts. As another example, if a person subscribes to MCI's AnyTime Option, they pay $9.90 for sixty minutes of interstate calls. That amounts to 16.5 cents per minute. If one of those subscribers were to make less than 52 minutes of calling, then their average rate would exceed 18.9 cents per minute, the average direct-dialed basic rate I calculated for AT&T's customers in the (continued...)

to residential customers as a whole, since a far smaller fraction of residential customers subscribe to MCI than subscribe to AT&T, and, as I have reported, 62 percent of AT&T's residential customers in BellSouth's states face full basic rates. Even if every one of MCI's residential customers who has a calling plan actually were to receive a discount, then 55 percent of residential customers for AT&T and MCI combined still face full basic rates.[9]

25. As Professors Hubbard and Lehr did, Professor Hall advocates using average revenue per minute as the relevant measure of rates, though as I mention above, he qualifies his advocacy. (Hall, ¶¶ 127, 205) Yet, in an attempt to de-emphasize the importance of basic rates, he contradicts his own position by stressing that lower rates are *available* to customers via optional calling plans. (Hall, ¶¶ 139-141, 151, 196, 198, 200-201, 206)

26. Professor Hall's discussion of the availability of calling plans and the percentage of customers who currently take them does not address one of my principal points: the average rate that AT&T residential customers paid in BellSouth states increased about 12 percent from 1993 to 1996. Any improvement in the terms of calling plans and any increase in the percentage of residential customers who take them has been insufficient to prevent that increase in rates paid. (Declaration, ¶ 11) Professor Hall does not present any data that refute this finding.[10] He ignores my calculations of the change in AT&T's rates for residential customers. I have accounted for the discounts that residential customers received in 1993 and 1996.

(...continued)

BellSouth states. Parallel conclusions hold for MCI's new MCI One flat-rate plans, since they specify a $5 minimum, which the customer must pay if usage in a particular month falls below $5. In addition, subscribers to MCI's original Friends & Family plan receive only a five percent discount, and then only for calls to other MCI subscribers. (See CCMI, "Guide to Networking Services" (August 1997).)

[9] This calculation assumes that AT&T's and MCI's national shares of residential customers in 1996 were 69.9 percent and 13.7 percent, respectively. (Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, "Long Distance Market Shares" (July 1997), Table 9.) It also assumes that their market shares in BellSouth were equal to their national market shares and that MCI's fraction of residential customers with calling plans in BellSouth equals the fraction nationally.

[10] Professor Hall's summary of my findings omits this result. (Hall, ¶ 203)

Professor Hall explains that one of the potential problems with using average revenue per minute as a measure of price changes is that it entangles rate changes with what he calls "mix effects." (Hall, ¶ 127) That is, changes in demand patterns cause the average revenue per minute to change even if no rates have changed. The primary difference between my estimates of rate changes and the changes one would calculate from average revenue per minute is that I have eliminated those "mix effects" that distort the average revenue per minute. Based on Professor Hall's own logic, he should rely more on my estimates than on any data on average revenue per minute.

27. Professor Hall criticizes my use of toll billing data from PNR and Associates. (Hall, ¶¶ 143-145, 205) He claims that "the PNR sample is badly biased, through its construction, in favor of smaller users."[11] AT&T presented results to the FCC using PNR's data, and it did not warn the FCC of any deficiencies.[12] For my declaration in this proceeding, I used PNR's 1996 data, not the 1995 data on which Professor Hall comments. He appears to be unaware that the 1996 data include weights to make the sample representative, and I used the weights in my calculations.[13] His criticism is thus moot.

28. Professor Hall goes on to say the following:

> I do not believe that the PNR data are usable to measure actual residential prices. Instead, I believe that the best way to measure those prices is by revenue per

---

[11] Professor Hall also claims to have verified his presumption that the sample is biased by selecting too many low-usage customers. He says, regarding the 1995 PNR data, "According to PNR, about 54 percent of MCI residential customers spent $10 or less on long distance. In the MCI data, the corresponding fraction is only 32." I believe he has misinterpreted the PNR data. According to PNR and Associates, the results he received from PNR were for all customers who made calls using MCI, not just those who presubscribed to MCI. Naturally, customers who occasionally use MCI on a non-presubscribed basis will have low usage. He compared a result for that group with a result from internal MCI data for MCI presubscribed customers. Thus, his comparison is invalid.

[12] Letter from C.L. Ward to W.F. Caton, March 9, 1995; Re: Ex Parte Presentation (CC Docket Nos. 79-252, 93-197, 80-286) D.J. Quinn, "The Light User Segment of the Long Distance Market," March 8, 1995.

[13] PNR and Associates constructed these weights using household data on age, income, household size, and census region.

> minute. As I showed in Section III, revenue per minute has fallen every year since 1985. (Hall, ¶ 205)

29. The above statement is highly misleading. First, as I note above, my calculations using the PNR data yield results similar to those which data on residential average revenue per minute would show, except that I remove the effects of changing demand patterns, which avoids a disadvantage of average revenue per minute that Professor Hall mentions. I do not use "theoretical calculations based on price plans and hypothetical distributions of customers among plans," as he appears to presume. (Hall, ¶ 205) Rather, using the 1996 data from PNR and Associates, I compare the prices actually paid by AT&T residential customers with what they would have paid for their specific calls under basic rates. Second, his statement gives the reader the impression that he showed in his Section III that residential average revenue per minute declined every year since 1985. Yet his Section III showed no such thing. Instead, it showed average revenue per minute for residential and business customers combined. Since business customers have benefited from much larger rate decreases than residential customers have, his aggregate data tells us nothing about average revenue per minute for residential customers alone.

30. Professor Hall also comments that up to a quarter of residential customers make no toll calls in a given month. Although that might be roughly correct, it does not affect any conclusions. A given customer's usage varies from one month to the next. Very few customers make no toll calls for an entire year; *i.e.*, the expected usage of almost all customers is positive. While some customers make no toll calls in a month—and thus their usage is below their mean in that month—others make more toll calls than their mean. A month's data is representative of the distribution of calling by all residential customers. Contrary to the impression he gives, Professor Hall's comment therefore does not imply that my statistics are invalid.

31. Professor Hall claims that my "discussion of AT&T's One Rate plan has been rendered completely obsolete by the One Rate Plus plan, which prices all long-distance calls by 10 cents per minute. This plan was in existence when Professor Schmalensee wrote, but he ignored it." To set the record straight, at the time I wrote my declaration, AT&T's One Rate Plus plan was

indeed in existence, but AT&T was not actively promoting it. In fact, a colleague of mine had to badger an AT&T service representative into revealing the fact that it was available. Therefore the plan hardly warranted my attention. Now that AT&T is voluntarily telling customers about the plan, perhaps someday enough customers will take the plan that it will significantly affect AT&T's average revenue per minute. Only then will it have become relevant according to the measure that Professor Hall himself advocates should be used to evaluate rate changes.

32. On the other hand, with its $4.95 per month subscription fee, AT&T's One Rate Plus plan is certainly not for low-usage customers. For instance, for a typical customer with less than 100 minutes of use per month, the original One Rate plan is less costly. Further, for a typical customer with monthly usage of 50 minutes or less, even basic rates would be less costly than the One Rate Plus plan. Thus, Professor Hall is wrong when he says "One Rate Plus is a sure bargain for any of the subscribers considered by Professor Schmalensee on pages 9 and 10 of his affidavit." (Hall, ¶ 206)

33. Professor Hall dismisses evidence that rates are higher than costs for low-usage customers by saying, "In a competitive industry, prices to each class of customer will reflect the costs of serving the class, including the costs associated with adding a customer, even if those costs do not vary over the customer's usage." (Hall, ¶ 208) He ignores my evidence that, using AT&T data and his own data, there is a large group of customers for whom rates are higher than costs. (Declaration, ¶¶ 15-17) I used this evidence to help show that the current long distance market is not fully competitive for residential customers and thus entry by a strong competitor such as BellSouth would either reduce long distance prices or improve the value that customers receive. Instead of refuting the point with evidence, he uses the circular argument that rates cannot be higher than costs because he assumes the long distance market is competitive.

34. Professor Hall also fails to explain a quandary. On the one hand, as I mention above, he asserts that rates for each class of customers equal the costs of serving each class. In 1996, 62 percent of AT&T customers faced full basic rates. In the BellSouth states, the average basic

rate for direct-dialed domestic calls was 18.9 cents per minute. According to his logic, then, it must have cost 18.9 cents per minute to acquire and serve those customers. Why, then, did AT&T suddenly decide it was profitable in early 1997 to offer its 15-cent-per-minute One Rate plan, for which all those customers would be eligible? Professor Hall gives no hint as to what suddenly reduced the costs of serving all those customers by 4.9 cents per minute. I suggest, to the contrary, that long distance carriers' costs did not suddenly drop by that amount in early 1997. Either revenues from those customers exceeded the costs of acquiring them and serving them, or AT&T feels confident that few of them will learn about and subscribe to the new One Rate plan, or both.

III. CARRIER ACCESS RATES ABOVE COSTS WILL NOT HARM COMPETITION

35. As I explained in my declaration, access charges are above costs. I also explained why that fact would not harm competition in the long distance market if BellSouth were to enter it; rather, BellSouth's entry would tend to reduce long distance prices and increase economic welfare. Several commenters appear not to understand this point, so I review the issue here.

36. Regarding this subject, I explained two points in my declaration. The first explanation was the invalidity of what I call the naïve price squeeze argument. An argument that some economists have often put forth on behalf of the incumbent long distance carriers has been the following: A vertically integrated RBOC would increase its access profits by taking toll minutes away from competitors. Therefore, entry by the RBOCs should be postponed until access charges are reduced to costs. My declaration showed that this argument is fallacious. (Declaration, ¶ 39-43) The reason for this conclusion is that every toll minute taken away from a competitor has an opportunity cost—foregone access revenue. I explained that the local exchange carrier might increase its profits if prices are above costs in the long distance market, but it would have this same profit incentive even if access rates were equal to costs. (Declaration, ¶¶ 44) If prices are above costs in the long distance market, then entry is warranted and would increase welfare. Thus, there is no reason to postpone BellSouth's entry into the long distance market until it reduces access charges to cost. Fortunately, most of the

economists in this proceeding have avoided the fallacious naïve price squeeze argument. (Except see my discussions of Professors Hubbard and Lehr and of Professor Baumol below.)

37. My declaration also demonstrated that, since access charges exceed access costs, local exchange carrier entry into the long distance market would improve economic welfare: I explained that a local exchange carrier increases its access profits if demand for its access services increases. Thus, it has an incentive to have its long distance affiliate induce or force a decrease in the prices of long distance services. (Declaration, ¶¶ 45-47) Professor Hausman (on behalf of BellSouth) also makes this point. I would also argue that it would similarly have a profit incentive to improve quality or service or to introduce new services and applications; any such improvements would stimulate demand just as price decreases would.[14] To help stimulate such demand increases, the local exchange carrier would want its long distance affiliate to charge lower prices, offer higher quality and service, and introduce more new services and applications than the affiliate might choose to do based on its own internal profit calculations. Since both access rates and long distance rates are currently above costs, the resulting demand expansion would increase consumer economic welfare and total economic welfare.[15]

38. As I discuss further below, several commenters appear to understand that the vertically integrated local exchange carrier would have a profit incentive to expand industry output. However, all of them (except Professor Schwartz ¶¶ 64-65) miss or ignore the point that such output increases would increase economic welfare. Therefore, they also miss the crucial point that follows from this finding: economic welfare gains from BellSouth's entry into the long distance market would be larger now—while access charges are still higher than costs—than such gains would be later when local competition competes down access prices closer to costs.

[14] Any such improvements implemented through changes in access services would also be available to the long distance rivals.

[15] I also reviewed an issue raised by Professor Franklin Fisher. He said that the local exchange carrier might expand even if it were less efficient than its rivals. I cited a paper showing that, for wide ranges of reasonable parameters, this potential inefficiency would be overwhelmed by the consumer welfare gain from expansion of demand. (Declaration, ¶¶ 46-47) None of the commenters refutes this finding.

(See, *e.g.*, Baseman and Warren-Boulton, ¶ 63, where they say there is no significant social cost to waiting.) On behalf of consumers, there is urgency to BellSouth's entry.

A. Professors Baseman and Warren-Boulton Regarding Access Charges

39. Professors Baseman and Warren-Boulton understand that a local exchange carrier with a long distance affiliate will want to expand demand in the long distance market. (Baseman and Warren-Boulton, ¶ 30) They miss two important and related points following from that finding, however: First, they miss the point that the local exchange carrier's expansion of the long distance market improves economic welfare. Second, they misinterpret the local exchange carrier's incentives as an undesirable competitive advantage. In reality, as my discussion of the invalid naive price squeeze argument showed, the local exchange carrier gains no access profits if its long distance affiliate takes toll business away from a long distance competitor. Its only access profit gain comes from inducing customers to expand their usage relative to what they maintained under the competitor. The local exchange carrier gains just as much access profit whether its own affiliate receives the stimulated usage or whether a long distance competitor does so. Unless the margin between current long distance prices and marginal costs is substantial—which many of the commenters deny[16]—the local exchange carrier would make far more profit if its long distance rivals would all reduce prices and thereby expanded industry demand generally than it would if its own long distance affiliate merely took away some share of customers from its rivals and expanded only their demand. If, on the other hand, the margin between current long distance prices and marginal costs is substantial, then it would be economically efficient for the incumbent long distance carriers to lose some of their customers to another carrier which offers them greater value via expanded usage. That is what the competitive process is supposed to do.

---

[16] See, *e.g.*, Hubbard and Lehr, ¶ 83. Hall asserts that the incremental revenue from additional customers equals the incremental costs of obtaining and serving those customers. (Hall, ¶ 130) Professor Baumol asserts that current long distance prices are above incremental costs. (Baumol, ¶ 36)

40. From whatever source, the demand expansion improves economic welfare. As I discuss above, for residential customers at least, current rates exceed the long distance carriers' costs. In the face of price, service, or quality competition from a BellSouth long distance affiliate, I would expect the incumbent long distance carriers to shave their margins rather than to stand pat and lose a substantial portion of their residential business. From the point of view of consumers, this would be good news and would increase consumer welfare.

41. Oddly, Professors Baseman and Warren-Boulton accuse me of ignoring the argument that the local exchange carrier would want its affiliate to induce an expansion of long distance output. (Baseman and Warren-Boulton, ¶ 84) Yet my declaration explicitly dealt with the issue. (Declaration, ¶¶ 45-48) I can only assume that they overlooked my discussion of it. As I mention above, that expansion would increase economic welfare.

42. After divestiture and before interstate access price caps, AT&T also had a lower marginal cost of switched access than did its nascent competitors MCI and Sprint. Therefore, it could offer non-linear pricing plans with lower marginal prices than its competitors would have found profitable. It also could increase profits by migrating many of its large business customers from private line services to switched services. What caused AT&T's lower marginal cost of switched access was often referred to at the time as the "Brandon effect." After divestiture, the local exchange carriers had a fixed interstate revenue requirement for the carrier common line charge, independent of usage, and they were rate-of-return regulated.[17] AT&T had almost the entire market for long distance service. In those circumstances, visualize AT&T's business case for a new optional toll calling plan with volume discounts. Such an offering would stimulate demand for toll service. To the same extent, it would increase the volume of access that AT&T bought from the local exchange carriers. Initially, AT&T's access bill would rise. But that would cause the local exchange carriers' revenues to exceed their revenue requirements, since that for the carrier common line was independent of usage. To

[17] AT&T also lobbied hard to get the states to establish a fixed revenue requirement for state carrier common line charges.

prevent their rates of return from exceeding their costs of capital, the FCC would force them to reduce their carrier common line rates. Therefore, AT&T could anticipate that its bill for the carrier common line charge would fall back virtually to where it was before its new service offering. In other words, when AT&T had almost all of the long distance market, its marginal cost for the interstate carrier common line was near zero. (After AT&T lost market share and the local exchange carriers reduced the carrier common line charge, the Brandon effect still operated but with lesser force.[18] It weakened further after the FCC instituted access price caps.) At the time, the FCC declined to interfere with AT&T's having artificially lower marginal costs, and AT&T lost market share regardless of its lower marginal costs of access. The implications of these observations are the following: if a carrier has artificially lower marginal costs than its competitors do, that situation will stimulate market growth; however, that situation has clearly not played a dominant influence in telecommunications markets to the disadvantage of competitors.

43. Professors Baseman and Warren-Boulton make another argument regarding access charges that makes no sense to me. They posit a knife-edge situation in which "access profits are close to the point where regulators would be inclined to reduce the access rate." (Baseman and Warren-Boulton, ¶ 30) In that situation, they claim that the local exchange carrier would *de facto* waive access charges to its long distance affiliate. Then, according to them:

> Access profits go down as the affiliate takes business away from independent IXCs, thus removing the threat that regulators will force an across-the-board access price reduction. (Baseman and Warren-Boulton, ¶ 30)

44. That sentence appears to be based on ignorance of the way in which regulated operations occur. The long distance affiliate would buy its access from a tariff. Whenever any party buys a tariffed item, the regulated accounts have to show revenues for the item, or routine audits—internal, regulatory, or independent accounting audits—would uncover the

---

[18] It can be shown that AT&T's long run marginal cost of the carrier common line charge was MC = (1-Market Share)*P, where P stands for the tariff rate for the carrier common line.

discrepancy. Regulators in particular are intensely interested and conscientious in preventing and uncovering any such behavior, and the penalties for such behavior would be substantial. Professors Baseman and Warren-Boulton give no clue as to how such a trick could be carried out or could succeed. I dismiss the practical relevance of this scenario. Professor Baumol also understands that argument does not work. (Baumol, ¶ 13)

B. Professor Baumol Regarding Access Charges

45. Professor Baumol has written his comments at a highly abstract level, with little detail, so I find it difficult to tell on which theory and assumptions he bases his conclusions. I am mainly concerned that his comments appear to rely on the naïve price squeeze argument, as signaled by, among others, these sentences:

> . . . where the owner of the bottleneck is unconstrained in the pricing of its bottleneck services [*i.e.*, access], there is the marked danger that it will sell them to its rival on considerably less advantageous terms than it does to itself. If this occurs, obviously the entry of the bottleneck owner into the competitive final product market [*i.e., the interLATA toll market*], can handicap it seriously and even destroy it. (Baumol, ¶ 10)
>
> . . .
>
> These techniques include . . . Vertical price squeezes—that is, raising the price of an essential facility (i.e., access to the local network) high enough in relation to the bundled price of local exchange and interexchange service so that the resulting margin is too small to cover the incremental costs of efficient competitors. (Baumol ¶ 39)

46. To the extent that he is relying on the invalid naïve price squeeze argument, his conclusions and policy recommendations are also invalid.

C. Professor Hall Regarding Access Charges

47. Professor Hall understands the invalidity of the naïve price squeeze argument. (Hall, ¶¶ 82, 191) He even quotes part of my refutation of the argument. (Hall, ¶ 191) However, to criticize a conclusion by Professor Hausman, he misapplies my findings. Professor Hausman's conclusion was based on the knowledge that current access charges exceed the local exchange

carrier's marginal costs of access. Therefore, to increase its access profits, the local exchange carrier with a long distance affiliate will want to expand industry output beyond what it would have been without its long distance entry. In other words, it wants to induce or force lower industry prices. I wrote the above-quoted passage in my declaration to show that a local exchange carrier does not increase access profits if its long distance affiliate takes a given number of toll minutes away from a competitor. Contrary to Professor Hall's impression, this latter proposition does not contradict Professor Hausman's proposition. Indeed, as I explained in my declaration and as I reviewed above, Professor Hausman is correct.

48. Professor Hall claims, "Because of the opportunity cost, the long-distance affiliate will set a price comparable to existing prices and will not have an incentive to deliver significantly lower long-distance prices to the consumer." (Hall, ¶ 191) Similarly, he also says, "[Professor Schmalensee] disposes quickly of the suggestion that a dominant local carrier would use its access cost advantage to offer bargains in the long-distance market." (Hall, ¶ 210) Professor Hall is wrong in that first sentence and misinterprets my findings in the second sentence. There are at least three ways in which he is wrong. First, even though the local exchange carrier gains no access profits if its long distance affiliate simply takes a customer away from a long distance rival, its marginal cost of additional usage is lower than that of rivals. Therefore, in a world with linear prices, its profit-maximizing price would tend to be lower than that of its rivals. This lower price stimulates demand for that customer. Second, non-linear prices are widely used in the long distance industry. With a lower marginal cost than its rivals have, the affiliate would tend to charge marginal prices that are lower than it would if it had higher marginal costs. (Professors Baseman and Warren-Boulton recognize this fact, contradicting Professor Hall. (Baseman and Warren-Boulton, ¶ 30)) Third, the best of all outcomes for increasing the local exchange carrier's access profits would be if the affiliate's competitive pressures induced the rivals to meet the competition, stimulating demand from all customers, whether served by the affiliate or not. All three of these effects would increase economic welfare.

49. Professor Hall also asserts that Professor Hausman "is suggesting that the local carriers sacrifice the revenue they currently earn from access charges." (Hall, ¶ 193) Professor Hall has

this completely wrong. He appears to have temporarily forgotten what he and all other economists know—reducing prices will increase profits if marginal revenue exceeds marginal costs. Further, he has forgotten that use of non-linear pricing schedules can increase profits when price exceed marginal cost.

D. Professors Hubbard and Lehr Regarding Access Charges

50. I regretted finding that Professors Hubbard and Lehr appear to cling to the myth of the naïve price squeeze argument. (Hubbard and Lehr, ¶¶ 92-93) I will not repeat my explanation from above. They are wrong. Although the local exchange carrier has an interest in expanding long distance demand, it cannot increase access profits simply by taking customers away from rivals at their previous level of usage. It increases access profits only by stimulating the customer's usage, which increases economic welfare.

E. Professor Schwartz Regarding Access Charges

51. Professor Schwartz recognizes the validity of the argument that a local exchange carrier entering the long distance market would have an incentive to expand long distance demand. He also considers limitations on this incentive or countervailing forces. Specifically, he says the following (Schwartz, ¶ 65):

- imputation requirements might limit the ability to implement actions consistent with that incentive;
- incumbent long distance carriers entering the local market would have similar incentives;
- BOCs would have a countervailing incentive to raise rivals' costs or degrade their quality for the purpose of *raising* interLATA prices; and
- BOC access margins are falling, so the expansionist incentive is moderating.

Whether imputation requirements would limit or even prevent the ability to stimulate toll demand depends on how they were administered—whether at a rate element level or at an aggregate level. Clearly, a detailed and rigid application of imputation requirements would prevent economic welfare gains. I agree with Professor Schwartz that long distance carriers entering the local market would have similar incentives to stimulate market demand. However, I fail to see that this point implies that the welfare-increasing incentive of the BOCs should not be given a chance to operate. We would improve welfare in the industry faster and by a greater amount if the BOCs *and* the long distance carriers vertically integrated rather than if only one class of them did. Finally, although I agree that access margins are falling, that implies a greater, not lesser, urgency to have the BOCs enter the long distance market, while they can still contribute to an increase in the market's economic efficiency through eliminating the double marginalization, as Professor Hausman calls it.[19]

F. Professor Shapiro Regarding Access Charges

52. Professor Shapiro appears also to understand that a local exchange carrier's long distance affiliate would tend to stimulate long distance usage in the market. (Shapiro, p. 11) As the others do, however, he ignores the fact that this tendency increases economic welfare and misinterprets it as an undesirable competitive advantage.

[19] I leave to others the role of responding to Professor Schwartz' third point, since that issue was not the focus of my declaration. By omitting discussion of it I do not mean to imply agreement with Professor Schwartz' position.

I declare under penalty of perjury that the foregoing is true and correct. Executed on November 13, 1997.

6

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Application by BellSouth Corporation, BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in South Carolina	CC Docket No. 97-208

AFFIDAVIT OF MELVIN R. SHINHOLSTER

1. My name is Melvin R. Shinholster. I am a manager with BellSouth Public Communications, Inc. (BSPC) located at 75 Bagby Drive, Homewood, Alabama. At the request of counsel for BellSouth, I have investigated the claims submitted by IPSPCC members or representatives included in Exhibit D of the Comments submitted on behalf of the IPSPCC and have prepared this affidavit discussing the results of this investigation.

2. The common points made by the IPSPCC appear to be about the practices of the BSPC Business Office when an interexchange carrier calls the BSPC Business Office with the location provider on the line.

3. The claims fall into five specific categories:

A.) Rudeness on the part of BellSouth Public Communications Service Representatives with IPSPCC members.

The procedures outlined for service representatives involved in a three-way conversation with interexchange carriers and customers provide for the service representative to:

- Cooperate with all parties on the line. The service representative will make every effort to handle the request both professionally and promptly.
- After announcing payphone numbers and customer, IXC representative is allowed to stay on line as an observer only.

B.) Service representatives refuse to make PIC changes because the customer was under a contract with Teltrust.

In a three-way conversation, the BellSouth Public Communications service representative is under instructions not to change the PIC at that time if the customer's account is shown to be under contract and Teltrust is shown to be the presubscribed carrier, thus indicating that BSPC has been authorized to select the PIC on behalf of the location provider. Where a contract does exist, the BellSouth Public Communications service representative is instructed to refer the contact to sales in order that the account representative can explain the terms of the existing contract to the customer since the service representative does not have access to the contract at his terminal. A PIC change may have an effect on the contract terms. The account representative is to contact the customer and explain the terms of the agreement with BSPC. If the customer requests a copy of the contract one will be faxed or mailed to him.

C.) The IPSPCC claims that BellSouth Public Communications service representatives will not answer questions about the contract when asked and would only state that someone from sales would contact the customer to discuss the existing contract.

My investigation revealed that the BellSouth Public Communications service representative is following established procedures by not discussing the contract with anyone other than the customer of record. Guidelines state that the interexchange carriers can establish a three-way conversation with the customer, introduce themselves and the customer, give pertinent information to the service representative and then hand the conversation over to the customer. The interexchange carriers can then choose to drop from the conversation or remain on the line to observe the call. They are not allowed to participate in the conversation once the interexchange carrier has handed the customer off to the service representative.

D.) The statements claim that the BellSouth Public Communications service representatives do not change the PIC upon request as they once did.

After April 1, 1997 BellSouth Public Communications, Inc. became a separate subsidiary of BellSouth and now operates as a certified Independent Payphone Provider in a nine - state area. As an Independent Payphone Provider, we maintain our own business office separate from the IPP services which are offered by the BellSouth Telecommunications Inc. Vendor Payphone Center. The BellSouth Public Communications service representatives are responsible for ordering access lines from Vendor Payphone Centers of the Local Exchange

Companies (including BellSouth Telecommunications) and maintaining the customer record data base for our public pay telephones just as other PSPs do for their payphones. BSPC service representatives are different from BellSouth Telecommunications Inc. service representatives who negotiate service requests for access lines. BellSouth Public Communications, Inc. has specific procedures for handling three-way calls with interexchange carrier representatives and customers as outlined in the BSPC office procedure manuals. Prior to the time that BSPC was authorized to select the interexchange carrier on behalf of the location provider, a PIC change request would have been processed at the time of the three-way call. Since April 16, 1997, when BSPC was authorized to contract with the location provider to select the interexchange carrier, this procedure was changed to that set forth in 3.B.

4. Finally, I investigated the specific allegations listed in Appendix D of the IPSPCC's comments. In some instance (e.g., Mr. Oldham), the IPSPCC's allegations are so vague as to make any type of investigation impossible.

In two other instances (Johnson's Game Room, Sal & Judy's), the IPSPCC fails to recognize that the payphones at issue subscribe to BSPC's Business Payphone Service. As explained in BellSouth's South Carolina Section 271 filing, the surcharge on such phones is entirely consistent with this Commission's payphone orders.

In another instance (B&B Spirits), the IPSPCC alleges that BSPC improperly refused to effectuate a PIC change requested by a location provider. But according to BSPC's records, B&B Spirits -- the party identified on the three-way call as the location provider -- was in fact not listed as the person authorized to select the interLATA carrier for that phone. Following the procedures described above, the BSPC representative thus refused to perform the PIC change. In any event, since this phone is not currently presubscribed to the BellSouth-preferred carrier, IPSPCC is entirely wrong in suggesting that BSPC would have an incentive to not perform a proper PIC change request.

Finally, in virtually all the other incidents identified by the IPSPCC, the location providers have appointed BSPC as their agent to act on their behalf in negotiating with interexchange carriers. Accordingly, whenever a location provider and an IXC requested a PIC change for any of these phones, the BSPC representative followed the procedures described above. The IPSPCC also mistakenly implies that BSPC has consistently failed to make the requested PIC change. For instance, the IPSPCC suggests that BSPC has attempted to "sell long distance" to Floyd Oil Company. In fact, however, that payphone is still currently presubscribed to NOS.

To the best of my knowledge, in dealing with requested PIC changes BSPC has followed the procedures described herein.

Under penalty of perjury, I hereby swear that the foregoing is true and correct to the best of my information and belief.

Melvin R. Shinholster
Manager
BellSouth Public Communications

Subscribed and sworn to before me this
13th day of November, 1997.

Sharon J. Greer
Notary Public

NOTARY PUBLIC STATE OF ALABAMA AT LARGE.
MY COMMISSION EXPIRES: Feb. 14, 2001.
BONDED THRU NOTARY PUBLIC UNDERWRITERS.

7

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Application by BellSouth Corporation, BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in South Carolina	CC Docket No. 97-208

REPLY AFFIDAVIT WILLIAM N. STACY

William N. Stacy, being duly sworn, deposes and says:

I. PURPOSE OF THE AFFIDAVIT

1. Having provided an affidavit addressing Operations Support Systems (OSS) in BellSouth's filing of its application for interLATA relief in South Carolina, this affidavit responds to those OSS comments raised in opposition to that application where clarification of OSS issues is required, or where the "facts" cited by commenters are in need of correction. First, I address some general issues. Second, I address comments related to pre-ordering issues, followed by ordering and provisioning issues. Lastly, I address capacity, testing, and documentation concerns.

II. GENERAL

2. The DOJ bolsters its position on BellSouth's OSS interfaces for CLECs by referring to the Florida Public Service Commission's Staff Recommendation of October 22, 1997, the Alabama Public Service Commission's Order of October 16, 1997, and an article from *Communications Daily* about the Georgia Public Service Commission, but ignores or